

3406 with respect to a short sale only if at the time the short sale is initiated, the broker expects that the amount of gain realized upon the closing of the short sale will be determinable from the broker's records. If, due to events unforeseen at the time the short sale was initiated, the broker is unable to determine the basis of the property used to close the short sale, the property must be assumed for this purpose to have a basis of zero.

(ii) *Time of backup withholding.* The determination of whether a short seller is subject to withholding under section 3406 must be made on the date of the initiation or closing, as the case may be, or on the date that the initiation or closing, as the case may be, is entered on the broker's books and records.

(5) *Fractional shares.* A broker is not required to withhold under section 3406 with respect to a sale of a fractional share of stock resulting in less than \$20 of gross proceeds (as described in § 5f.6045-1(c)(3)(x) of this chapter).

[T.D. 8637, 60 FR 66118, Dec. 21, 1995, as amended by T.D. 9010, 67 FR 48760, July 26, 2002]

§ 31.3406(b)(3)-3 Reportable payments by certain fishing boat operators.

(a) *Payments subject to backup withholding.* A payment of a kind, and to a payee, that is required to be reported under section 6050A (relating to information reporting by certain fishing boat operators) is a reportable payment for purposes of section 3406. See § 31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding.* The amount described in paragraph (a) of this section subject to withholding under section 3406 is the amount subject to reporting under section 6050A, but only to the extent the amount is paid in money and represents a share of the proceeds of the catch.

[T.D. 8637, 60 FR 66119, Dec. 21, 1995]

§ 31.3406(b)(3)-4 Reportable payments of royalties.

(a) *Royalty payments subject to backup withholding.* A payment of a kind, and to a payee, that is required to be reported under section 6050N (relating to

information reporting of payments of royalties) is a reportable payment for purposes of section 3406. See § 31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding.* In general, the amount described in paragraph (a) of this section that is subject to withholding under section 3406 is the amount subject to reporting under section 6050N. However, if the reportable payment is for an oil or gas interest, the amount subject to withholding is the net amount the payee receives (i.e., the gross proceeds less production-related taxes such as state severance taxes).

[T.D. 8637, 60 FR 66119, Dec. 21, 1995]

§ 31.3406(b)(4)-1 Exemption for certain minimal payments.

(a) *In general.* A payor of reportable interest or dividends (as described in section 3406(b)(2)) or of royalties (as described in section 3406(b)(3)(E)) may elect not to withhold from a payment that does not exceed \$10 and that on an annualized basis does not exceed \$10 (see paragraph (c) of this section). A broker or barter exchange may elect not to withhold on gross proceeds of \$10 or less without regard to the annualization requirement. See § 31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Manner of making the election.* The election not to withhold from payments that do not exceed \$10 can be made only for payments described in paragraph (a) of this section. The election may be made on a payment-by-payment basis.

(c) *How to annualize—(1) In general.* To annualize a reportable interest payment, dividend payment, or royalty payment, a payor must calculate what the amount of the payment would be if it were paid for a 1-year period (instead of the period for which it actually is paid). The annualized amount is determined by dividing the amount of the payment by the number of days in the period for which it is being paid and then multiplying that result by the number of days in the year. If the annualized amount is \$10 or less, the payor may elect not to withhold on

that payment regardless of whether more than \$10 may be or has been paid to the payee in other reportable payments during the calendar year. Conversely, if the annualized amount is more than \$10, withholding applies even if \$10 or less is actually paid to the payee during the calendar year. For purposes of computing the annualized amount, the payor may assume that February always consists of 28 days and that the year always consists of 360 days. For amounts that are deposited with a payor in a new account or certificate between the dates on which the payor customarily pays or credits interest, the payor may assume that the period for which the interest is paid is the payor's customary period for paying or crediting interest.

(2) *Special aggregation rule for reportable interest and dividends.* If a payor maintains records that reflect multiple holdings of one payee and the payor makes an aggregate payment of reportable interest or dividends (as defined in section 3406(b)(2)) with respect to those multiple holdings (such as a dividend check that reflects payment on all stock owned by the payee), the payor must annualize the aggregate payment.

(d) *Exception for window transactions and original issue discount.* A payor is not required to annualize payments made in window transactions (as defined in § 31.3406(b)(2)-3(b)) or payments of original issue discount. With respect to a window transaction, however, the payor is required to aggregate all payments made in the same transaction (e.g., payments made with respect to coupons or obligations presented for payment at the same time as described in § 1.6049-4(e)(4) of this chapter).

[T.D. 8637, 60 FR 66119, Dec. 21, 1995]

§ 31.3406(c)-1 Notified payee underreporting of reportable interest or dividend payments.

(a) *Overview.* Withholding under section 3406(a)(1)(C) applies to any reportable interest or dividend payment (as defined in section 3406(b)(2)) made with respect to an account of a payee if the Internal Revenue Service or a broker notifies a payor under paragraph (c) (1) or (2) of this section that the payee is subject to withholding due to notified payee underreporting (as defined in

paragraph (b)(1) of this section), and the payor is required under paragraph (c)(3) of this section to identify that account. After receiving the notice and identifying accounts, the payor must notify the payee, in accordance with paragraph (d) of this section, that withholding due to notified payee underreporting has started. Paragraph (e) of this section describes the period for which withholding due to notified payee underreporting is required. Paragraph (f) of this section provides rules concerning notices that the Internal Revenue Service will send to a payee before notifying a payor that the payee is subject to withholding due to notified payee underreporting. Paragraph (g) of this section provides rules that a payee can use to prevent withholding due to notified payee underreporting from starting or to stop it once it has started. Paragraph (h) of this section provides special rules for joint accounts of payees who have filed a joint return. See section 6682 for the penalties that may apply to a payee subject to withholding under section 3406(a)(1)(C).

(b) *Definitions*—(1) *Notified payee underreporting.* Notified payee underreporting means that the Internal Revenue Service has—

(i) Determined that there was a payee underreporting (as defined in paragraph (b)(2) of this section);

(ii) Mailed at least four notices under paragraph (f)(1) of this section to the payee (over a period of at least 120 days) with respect to the underreporting; and

(iii) Assessed any deficiency attributable to the underreporting in the case of any payee who has filed a return.

(2) *Payee underreporting*—(i) *In general.* Payee underreporting means that the Internal Revenue Service has determined, for a taxable year, that—

(A) A payee failed to include in the payee's return of tax under chapter 1 of the Internal Revenue Code for that year any portion of a reportable interest or dividend payment required to be shown on that tax return; or

(B) A payee may be required to file a return for that year and to include a